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EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

October 25th, 1985

MEMORANDUM FOR HEADS OF DEPARTMENTS AND AGENCIES

FROM: James C. Miller III
Director

SUBJECT: Inquiries on Gramm-Rudman-Hollings from Capitol Hill

It has come to my attention that several departments/agencies have received Congressional inquiries concerning their views on the impact of the Gramm-Rudman-Hollings amendment to the debt ceiling bill. You should be aware that the President supports this legislation and is seeking its passage on Capitol Hill. For example, last week he said:

> Over the years, sincere efforts have been made by men and women of good will in both parties to solve the chronic problem of overspending by the Federal government. But the problem has not been solved. We cannot escape the simple truth that the budget process has failed . . . This legislation will impose the discipline we now lack by locking us into a spending reduction plan . . . If Congress cooperates and passes this legislation, we can send a clear and compelling message to the world: the United States government is not only going to pay its bills, but we're also going to take away the credit cards.

Also, it might be helpful if you were to review the attached testimony and questions and answers that state the Administration's position on this bill.

As you know, your responses to these inquiries should be submitted to OMB's Legislative Reference Division pursuant to OMB Circular A-19.

Thank you.

DCI EXEC REG

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EMBARGOED FOR RELEASE UNTIL THURSDAY, OCTOBER 17, 1985, 9:30 a.m.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

STATEMENT

of

JAMES C. MILLER III

DIRECTOR

OFFICE OF MANAGEMENT AND BUDGET

before the

SUBCOMMITTEE ON LEGISLATION AND NATIONAL SECURITY

COMMITTEE ON GOVERNMENT OPERATIONS

U.S. HOUSE OF REPRESENTATIVES

OCTOBER 17, 1985

Mr. Chairman and Members of the Committee: it's a pleasure to appear before you today to express the Administration's support for the Balanced Budget and Emergency Deficit Control Act of 1985, commonly known as the Gramm-Rudman-Hollings Act.

As you know, a House-Senate conference on this landmark legislation began yesterday. The conferees have an opportunity, in the Senate-passed amendment, to strike a decisive blow in solving one of the nation's most troublesome problems -- the chronic tendency for government to outspend its receipts.

Let me start by saying that the President supports this initiative wholeheartedly. To cite his own words:

> "Over the years, sincere efforts have been made by men and women of good will in both parties to solve the chronic problem of overspending by the federal government. But the problem has not been solved. We cannot escape the simple truth that the budget process has failed . . . . This legislation will impose the discipline we now lack by locking us into a spending reduction plan . . . . If Congress cooperates and passes this legislation, we can send a clear and compelling message to the world: the United States government is not only going to pay its bills, but we're also going to take away the credit cards."

I'd like to begin this morning by describing the legislation and how it works. I will then touch upon some of the concerns that have been raised about it and endeavor to address them. Finally, I will be glad to respond to any questions you might have, though I hope you will forgive me if after only nine days in office I don't possess the detailed knowledge of my legendary predecessor.

Mr. Chairman, to my mind Gramm-Rudman-Hollings represents the most serious Congressional attempt in years to address our spiraling Federal budget deficit. If passed, this legislation virtually assures that massive Federal borrowing to finance current expenditures will come to a halt. Gramm-Rudman-Hollings not only mandates lower budget deficits; it also provides a means of achieving them. If all else fails, the President is required to make across-the-board spending cuts that will keep the deficit on target.

This assurance of future cuts in the deficit (brought about by spending restraint) is very important from the standpoint of aggregate economic activity, because it could have a significant effect on expectations. Participants in financial markets can see in this initiative a strong signal that the deficit will be ended and may begin to alter their behavior accordingly. Everything else equal, positive results might well include a lowering of the real rate of interest, an increase in domestic investment (and thus job creation), and an improvement in our balance of trade. The latter is especially important, because it would reduce pressures for protectionist legislation and would improve agricultural exports.

The experience of the recent past has demonstrated that good intentions alone are not sufficient to deal with the budget deficit. Congress has not been able to control spending and has refused proposals to grant the President greater rescission authority or line item veto.

The President, both parties in Congress, and the general public are essentially unanimous in their view that the large budget deficit poses a threat to our future prosperity. But the present budget procedures, compounded by political gridlock, have proved incapable of making significant progress in bringing the deficit down. Something new must be tried.

Gramm-Rudman-Hollings mandates that the budget submitted by the President and the budget passed by Congress achieve the specified deficit targets. But the crucial difference from past efforts is that the Act contains a fail-safe mechanism. If the outcome of the President's proposal and Congress's action on the budget is a larger deficit than specified, or if changed economic conditions have led to the same result, then the President is required to take specific steps, according to a prescribed formula, to reach the deficit target.

I need to emphasize that in the event the President must act, the spending reductions are not at his discretion. While some parts of the budget, such as Social Security and interest on the national debt, are exempted, the rest of the budget must bear the cuts evenly, including defense and domestic programs.

Neither the President nor Congress may particularly like this outcome. Accordingly, under Gramm-Rudman-Hollings the President can propose a different means of reaching the deficit goal. And Congress, under an accelerated procedure, can adopt this or any alternative plan, subject to the usual procedures for enacting legislation. But until and unless such an alternative were enacted, the spending reductions proclaimed by the President would remain in effect.

The key first step in this new process occurs in late September each year. The Office of Management and Budget and the Congressional Budget Office jointly consider the budget outlook for the forthcoming fiscal year in light of what Congress has done and not done, and developments in the economy as they affect spending and receipts. They make both an economic forecast and a budget forecast. If they disagree, their report splits the difference.

If this joint report forecasts a deficit higher than the specified level for that year, with a margin of error of 5 percent (7 percent for FY 1986), then the provisions of the act are "triggered". Of course, if Congress has acted on a budget that meets the deficit target, the triggering should not occur. Thus, Presidential action to sequester spending should be the exception, not the rule.

The President's sequestering order must contain enough spending reduction to achieve the deficit target for that year. However, the order's content is carefully limited and spelled out in the law.

- The President's order first seeks to attain half of the needed deficit reduction by reducing or eliminating automatic cost-of-living adjustments in indexed benefit programs other than Social Security.

- To attain the other half, the order reduces controllable spending across the board by a uniform percentage. The law defines the meaning of controllable spending. Some elements of the budget, such as interest on the debt and most outlays resulting from contracts made in prior years, are clearly not controllable. Annually appropriated "discretionary" programs clearly are controllable. Some non-indexed entitlement programs are deemed controllable and some are not.

- o If the excess deficit is not eliminated by the sum of those two steps, the President's order must further reduce controllable spending to meet the target.

- o The reductions must be uniform, down to the appropriation account level of detail. No program, project, or activity can be eliminated. Because defense is controllable for the most part, it shares in the proportionate reduction.

I hope this gives you a picture of the essentials of how Gramm-Rudman-Hollings would work. Now let me make a few additional points, in anticipation of your questions.

First, this legislation does not, as widely claimed, give vast new discretionary powers to the President. He proposes a budget as before, but that budget must incorporate a deficit of no more than the target amount. Even in the event of sequestering of funds, the President's function is essentially ministerial -- imposing uniform percentage spending reductions across most of the budget. Thus, Gramm-Rudman-Hollings is entirely different from the line item veto, where the President would indeed have the power to pick and choose among programs.

Second, the legislation does not in any way "devastate" social programs or the safety net. Social Security, as you know, is exempt from any reduction. For some of the main benefit programs, the most that could be cut would be the annual cost of living adjustment, which at current inflation rates is small in any event. Other programs would be subject to a uniform percentage reduction, but in practice this percentage is likely to be small. One merit of the across-the-board approach is that a relatively small percentage reduction can achieve large savings. And it is important to remember that each year Congress can avoid the likelihood of any triggering of the automatic cuts by making the needed savings on its own.

Third, the legislation does not hamstring the government in the event of recession. The "automatic stabilizers" -- chiefly unemployment compensation -- work exactly as before. Discretionary spending increases would be proscribed, but if there is anything we have learned from the experience of the post-war recessions, it is that discretionary fiscal policy actions such as public works spending are the worst possible response, because they take effect after the recovery is already underway.

That concludes my statement, Mr. Chairman. With your permission, I'd like to submit for the record a short list of questions and answers addressing various aspects of Gramm-Rudman-Hollings. Now, I'd be pleased to address any questions you might have for me today.

Commonly Asked Questions

Question: What is the impact of Gramm-Rudman on Defense?

Answer: Gramm-Rudman is intended to be broad-based, and it includes Defense in the spending reduction. The Act exempts certain categories of spending from reduction, however, which includes that portion of defense outlays resulting from prior year contracts. Other elements of the defense budget are subject to reduction just as domestic programs are. The amount of the reductions borne by defense will be driven by the total reduction required. In the short term, 1986, defense may have to share as much as half of the total reduction if the Gramm-Rudman targets are not met.

Question: What is the impact of Gramm-Rudman on Military Pay?

Answer: The pay rates for both Service members and civilian employees of the Department of Defense and other agencies are not affected by Gramm-Rudman. Only the military retired pay automatic COLAs would be subject to reduction.

Question: What is the universe of controllable spending, both domestic and defense?

Answer: Under the terms of this statute, controllable spending is in two categories -- annually appropriated discretionary programs, and some entitlements. The following appear to fit the Act's definition of controllable expenditures.

A. Discretionary appropriations

-- Defense. The entire new appropriation, carryover unobligated balances, and other sources of funds are controllable, except military retirement. However, that portion of outlays that results from prior year contracts is not controllable.

-- Non-defense. Annually appropriated funds, carryover unobligated balances, and other sources of funds are controllable. The portion of domestic appropriation bills that funds

entitlements is normally not controllable, with exceptions noted below.

B. Entitlements considered controllable

-- Medicare*

-- Medicaid*

-- AFDC*

-- Guaranteed student loans (one-year lag)

-- CCC (one-year lag)

* Reductions in reimbursements to states and providers, not in benefits for individuals.

Question: The Act exempts from reductions outlays that result from contracts made in prior years, both defense and non-defense. How much is this?

Answer: There are actual figures for prior fiscal years and estimates for 1985 and 1986. These indicate the magnitudes involved. There are no estimates for 1987 or later years, because the figures will turn on contracts let in 1985 and 1986, which is not now known.

The estimate for 1986 is that payments from prior year contracts will total $109.2 billion for defense and $78 billion for non-defense agencies.

PAYMENTS FROM PRIOR YEAR CONTRACTS AND OBLIGATIONS
(dollars in billions)

	1980	1981	1982	1983	1984	1985 est.	1986 est.
National defense.......	36.5	41.4	56.9	68.3	79.5	91.3	109.2
Civilian programs......	66.7	67.2	64.5	60.4	65.8	75.7	78.0
Total, outlays from prior-year contracts and obligations..	103.2	108.6	121.5	128.7	145.3	167.0	187.1

Detail may not add to total due to rounding.

Question: Does this Act involve a transfer of power from Congress to the President? How much discretion can the President exercise in "sequestering" funds?

Answer: The proposal does not transfer power from the Congress to the President. The automatic sequestering authority is designed so that the President will act in an essentially ministerial fashion in imposing uniform spending reduction. The bill provides that the President must apply a uniform, across-the-board percentage spending reduction to specified categories of programs. Thus, unlike proposals such as the line-item veto, the President is not granted authority to pick and choose among the programs to be cut, or to determine what share of the total cuts individual programs should bear. Furthermore, the bill expressly provides that the President cannot use this authority to eliminate entirely any program, project or activity.

Question: Describe how sequestering works.

Answer: Sequestering would use the normal, long-established procedures by which Congress provides budgetary resources to agencies and programs within agencies. The key procedure is called "apportionment". The Office of Management and Budget determines the total funds available for each account each year -- from new appropriations, carryover unobligated balances and other sources -- and then apportions them to the agency throughout the year. If the Balanced Budget and Emergency Deficit Control Act spending reductions were triggered, the across-the-board percentage reductions would determine the amount to be sequestered, and this would be reflected in OMB's apportionments.

Question: What happens in case of recession?

Answer: The Act itself does not use the term recession. It does provide a delay -- from 14 days to 30 days -- in the President's proclamation of across-the-board spending cuts if the joint OMB-CBO economic forecast projects negative growth for the fiscal year in question or for two or more consecutive quarters. This provision for delay does not alter the requirement to proclaim across-the-board spending reductions if the forecast deficit is

above the level specified in the Act. But it does give the President and Congress more time to propose and act upon alternatives.

A recession could well happen, of course, even if it is not forecast. In that event, receipts would decline and some outlays such as unemployment compensation would increase, and the actual deficit would be larger than the amount specified in the act and targeted by the President and Congress. This is entirely permissible, and shows that the Act is not rigid. The "automatic stabilizers" would be allowed to operate, helping to shorten the recession and bring about recovery.